

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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In the Matter of)	
)	
Federal-State Joint Board on)	CC Docket No. 96-45
Universal Service, the Rural Task)	FCC - 01 - 8
Force Recommendation, and the)	
Joint Board's Recommended)	
Decision)	

**Comments of the
Rural Utilities Service**

The Rural Utilities Service (RUS) is a rural development agency of the United States Department of Agriculture. RUS promotes the universal availability of a broad range of telecommunications services in rural America through its Telecommunications Program.

The primary tools used by RUS to extend and improve telecommunications in rural areas are the Program's telecommunications and broadband loan programs. In making and servicing loans under these programs, RUS collects statistical information from approximately 800 rural telephone companies and cooperatives. This statistical resource was made available to the Rural Task Force for several types of analyses during its deliberations. One such analysis was when the Task Force considered lifting the caps on the high cost fund. In particular, information was requested which would show the return factors for RUS companies and cooperatives, which are rural telephone companies.

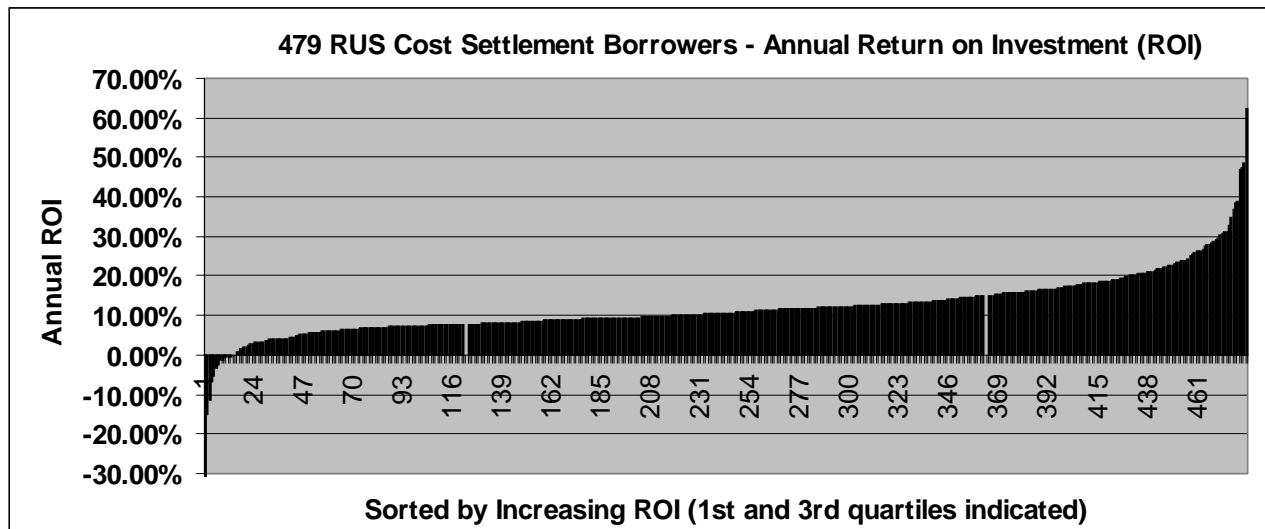
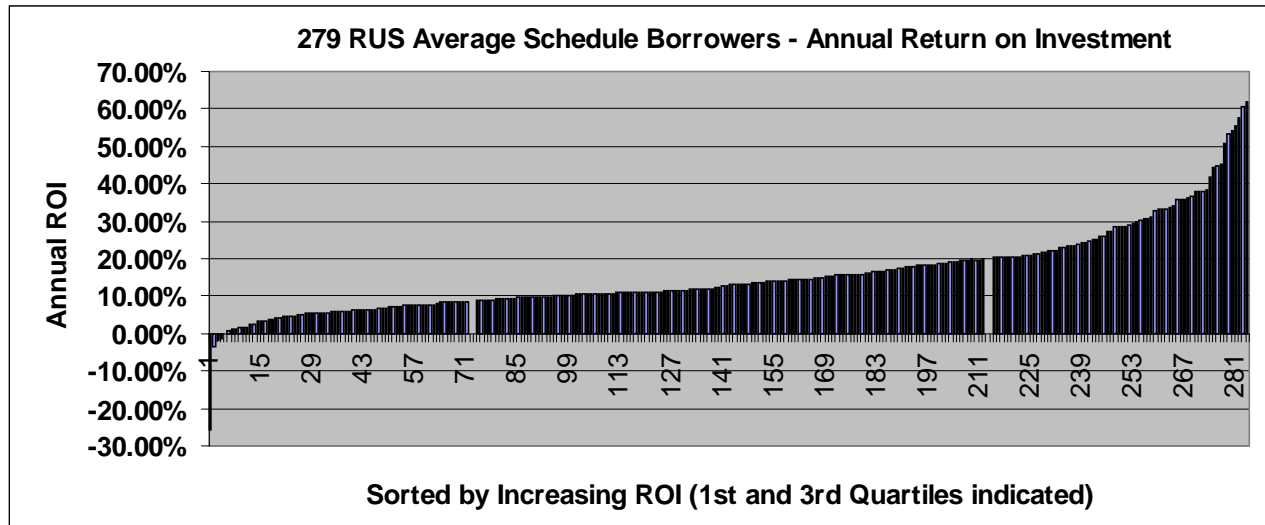
The Federal Communications Commission (Commission), in considering the adequacy of support, needs information on the financial strength of rural Local Exchange Carriers.¹ The RUS hereby files return on investment (ROI) information from the latest available Annual Statistical Report with the Commission.

RUS Financed Carrier's Returns on Investment are Not High

The following charts show ROI for both average and cost settlement borrowers. The distribution shows that ROI is consistent and relatively low for the vast majority of reporting RUS carriers.

1. See *In the Matter of Federal-State Joint Board on Universal Service*, Recommended Decision, CC Docket No. 96-45) rel. Dec. 22, 2000, at ¶12. This paragraph contains a discussion about whether the Recommended Decision provides the proper amount of support: "...While a significant number of commenters urge the Joint Board to recommend the Rural Task Force plan without modification, other commenters, including some rural carriers, believe that the Rural Task Force Recommendation would provide too little support. Still other commenters, including several state commissions and carriers, believe it would provide too much support. ..."

The ROIs ranged from a low of negative 38.94% to a high of 62.26% for cost settlement companies. As can be seen from the graph, ROIs drop off quickly from that high. Five of the 10 cost settlement carriers with the highest ROIs received no high cost loop support.



Aging Plant is a Primary Cause of High Return on Investment

A high ROI is not necessarily a result of a high level of income. It can also result from low expenses, and in particular, from low investment. In small companies, construction of the entire system at one time is often the only efficient way to build plant. Investment commitments are deferred until a large enough build can be planned and sufficient capital secured. This denies the small company the rolling replacements and the possibility of more stable depreciation reserve ratios found in large companies. Therefore, comparisons of ROIs between small and large carriers can be misleading. Small carriers, if they build and operate efficiently, will in the later stages of the life of their plant, have a relatively low level of investment that results in a relatively high indicated ROI. When these companies do replace their plant, their ROI will

generally plummet as they replace their older, lower cost depreciated loop plant. Loop plant, unlike electronics, has continued to increase in cost over the years and rural carrier's investment is dominated by loop plant. Increased plant costs are clearly indicated by increasing telephone plant in service per line shown below.

Although comparisons can be misleading, they are inevitable. The following tables show the summaries of the RUS statistics regarding ROIs for average and cost settlement telephone borrowers.

1999 Return on Investment (ROI) Analysis

For 279 RUS Borrowers on Average Settlement (Interstate)

Weighted Averages ^a	ROI (%) ^b	Depreciation Reserve Ratio (%) ^c	Net Plant per Line (\$)	Net Plant to Assets Ratio(%)
Mean	13.00	51.82	1,404	52.80
2 nd and 3 rd Quartiles	13.13	52.34	1,404	55.10
1 st Quartile	5.93	44.81	1,814	62.29
4 th Quartile	27.88	60.31	930	33.27
Statistical Measures ^d				
Median	12.89	52.66	1,298	46.94
1 st Quartile	8.65	45.33	1,037	35.13
3 rd Quartile	20.16	59.78	1,701	64.75

For 479 RUS Borrowers on Cost Settlement (Interstate)

Weighted Averages ^a	ROI (%) ^b	Depreciation Reserve Ratio (%) ^c	Net Plant per Line (\$)	Net Plant to Assets Ratio(%)
Mean	11.28	50.40	1,785	61.96
2 nd and 3 rd Quartiles	10.98	48.90	1,803	64.12
1 st Quartile	4.90	48.46	2,167	64.31
4 th Quartile	20.20	55.85	1,425	54.58
Statistical Measures ^d				
Median	10.52	49.80	1,895	56.97
1 st Quartile	7.74	44.42	1,373	44.02
3 th Quartile	14.90	59.71	2,925	68.92

- Determined by summing all occurrences in the category before calculating the percentage.
- Return equals total net telecommunications revenues, less operating expenses, state and local taxes and calculated federal income tax (if applicable) on net telecommunications income. Investment equals 1999 average net telecommunications plant, less reserves, plus material.
- Total depreciation and amortization reserve divided by telephone plant in service.
- Includes all borrowers that reported plant financial data 1998 and 1999.

The relationship between ROI and age of plant is demonstrated by these tables. For example, the RUS average settlement borrowers with the highest returns (4th quartile) have the highest depreciation reserve ratio and the lowest net plant per line. The median for the cost settlement borrowers is 10.52%, which is below the authorized 11.25% interstate rate of return. Also, the ROI for RUS borrowers is far below the Price Cap Companies, which reported a mean of 18.52% (interstate) for 1999.²

Rural LECs are Not Making Too Much, They are Investing Too Little

Rural LECs are not making too much on average. To the contrary, they are investing too little in telephone plant. This can be traced in part to uncertainties following the changes brought by the Telecommunications Act of 1996 and, in particular, the concern of rural carriers about the stability and sufficiency of universal service support. These uncertainties are reflected in the statistics below which show that the local exchange carriers facilities are aging (as shown by the steadily increasing depreciation reserve ratio).

RUS Borrower Plant Investment (1990-1999)*

Year	Total Plant in Service (\$)	Depreciation Reserve (\$)	Access Lines	Total Plant in Service/Line (\$)	Depreciation Reserve Ratio (%)
1990	13,268,005	5,142,721	5,720,005	2,320	38.8
1991	14,029,058	5,584,280	5,834,602	2,404	39.8
1992	14,878,290	6,114,242	6,110,615	2,435	41.1
1993	14,029,058	5,904,771	5,598,764	2,506	42.1
1994	14,878,290	6,253,557	5,538,207	2,686	42
1995	14,143,917	6,275,873	5,107,097	2,769	44.4
1996	15,369,985	7,076,937	5,380,389	2,857	46
1997	16,433,030	7,799,571	5,619,649	2,924	47.5
1998	16,623,970	8,168,903	5,477,668	3,035	49.1
1999	16,840,752	8,533,143	5,644,699	2,983	50.7

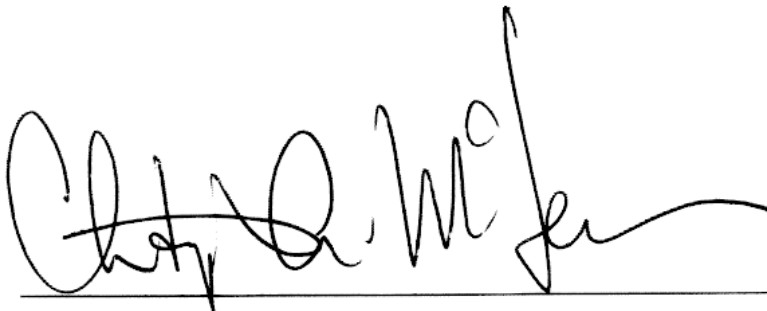
* Sources: 1990 to 1998 *Statistical Report, Rural Telecommunications Borrowers*, RUS Informational Publication 300-4 and 1999 Financial and Statistical Reports for Telecommunications Borrowers. The number of borrowers varies from year to year and not all data is submitted in time to be included in the published report. Nevertheless, the trends are clear.

2. See www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/ror99.pdf, at 7 (as of Jan.19, 2001).

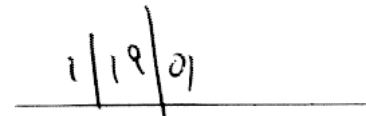
Conclusion

The carriers that report to RUS and are included in the above statistics, are representative of the rural carriers in general. These statistics show that rural carriers are not over-earning, they are under-earning when compared to price cap companies. In addition, the infrastructure of the rural carriers is aging. RUS does not believe that this is a recipe for closing the digital divide in rural America.

The evidence proves that the amounts received under the current system are not over-compensating carriers, and on a going forward basis, are insufficient to provide comparable services and access to advanced services. Reform as recommended by the Rural Task Force is fully consistent with and necessary to fulfill the vision of Sections 254 and 706 of the Telecommunications Act of 1996.

A handwritten signature in black ink, appearing to read "Chris A. McLean", written over a horizontal line.

CHRISTOPHER A. McLEAN
Adminstrator
Rural Utilities Service

A handwritten date "1/19/01" written over a horizontal line.

Date